

Economies of scale in bank mergers would be huge and synergy, not so hard to find

# Building Heavyweight Banks



**Hasmukh Adhia**

**T**he recent successful merger of two public sector banks (PSBs), Dena Bank and Vijaya Bank, with Bank of Baroda has paved the way for the future road map of PSB restructuring. It has created the right synergy, achieved scale and resulted in better shareholder value creation. It would be wrong to think that this move of GoI was in response to the difficult conditions that many PSBs find themselves in. Nor was it meant to provide protection to a 'weak' bank like Dena Bank (as it is perceived to be). This amalgamation is the result of a deliberated choice in the present world economy.

It is incongruous for the world's sixth-largest economy by GDP in 2018 to not have a bank ranked in the world's top 25 by size; China has six. The UK, whom we will overtake to become the fifth-largest economy this year, has three. Canada, the 10th-largest economy, has two, and Spain ranked 13th has one. In the world's top-ranked 100 banks by assets, India has one: SBI, which is ranked 60th. Clearly, size matters.

To be globally competitive, we have to build banks that are bigger and stronger than what we have at this time. The faster we do it, the better it would be. The amalgamation of the three banks is the first step to achie-

ving that goal.

Amalgamations bring value and efficiencies. Look at other jurisdictions; it has been happening for decades. Bank of America in the 1990s was the result of many banking institutions having merged; after it acquired Merrill Lynch in 2008, Bank of America Merrill Lynch is among the top 10 banks in the world, with \$2.28 trillion in assets in 2018 and a very healthy capital base.

We are also seeing this happen in the Indian context; the State Bank of India's (SBI) merger with its own five associate banks, and the merger of Bharatiya Mahila Bank with SBI was perhaps the first major case of merging multiple entities into one to create both scale and efficiencies. HDFC Bank, the largest private sector bank in India today, grew through a series of acquisitions. The amalgamation of ING Vysya with Kotak Mahindra Bank was to achieve significant gains.

## All-Cuisine Service

Consider this from a customer's perspective: Bank of Baroda's reach in the west and north, and Vijaya Bank's presence in the south of India makes the new entity an all-India bank now. It combines Bank of Baroda's expertise in dealing with very large corporate customers with Dena Bank's knowledge of MSME customers. Further, foreign currency funding will now be available to customers of Dena Bank and Vijaya Bank as also they will have access to Bank of Baroda's international presence at 101 offices. Customers of each bank in this amalgamation can now get integrated offerings, and cost effectively so.

Even if we don't factor consolida-



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## Well begun is half done

tion as strategic reform strategy, there is no rationale for having so many PSBs. With the government as majority owner in nearly 20 of them, governance challenges become more pressing. It is not easy for the government to manage so many entities and supervise them.

Consolidation — which is really what we are talking about, rather than a single amalgamation — has been on the government's mind for a long time. The second Narasimham Committee Report in 1998 recommended that amalgamations between strong banks "would make for greater economic and commercial sense and would be a case where the whole is greater than the sum of its parts and have a 'force multiplier effect'". However, the real action began only in the last four years.

In August 2017, the Union Cabinet approved a proposal to set up a ministerial panel to oversee banking industry consolidation, including amalgamations. The panel would review and approve amalgamation proposals presented by banks, with the objective of creating strong and stable banks, based on commercial viability. To enable quick decision-making, the government exempted

such amalgamations from seeking approval under fair trade rules as required by the Competition Commission of India. The exemption would be for 10 years so that consolidation could be fast-tracked.

## Too Big to Fail Us

While it is tempting to think of the Bank of Baroda-Dena Bank-Vijaya Bank amalgamation as a way to handle systemic challenges stemming from the large non-performing assets (NPAs) that have impacted bank balance sheets, that is far from the truth. Yes, the erstwhile Dena Bank may have benefited from the transaction, but that was a by-product, not the intention.

We do hope that the new government at the Centre will take forward the agenda of banking sector consolidation. India needs a strong banking system, supported by six or seven globally competitive large banks as the pillars, if we have to become a \$5-trillion economy by 2025. Urgent action by the new government in this direction will be the proof of concept of this national goal.

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